

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
December 20, 2002
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85012. Mr. Alan Maguire, Chairman, Arizona State Retirement System Board, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

1. Call to Order; Roll Call

Present: Mr. Alan Maguire, Chairman
Mr. Bonnie Gonzalez, Vice Chairman
Ms. Charlotte Borchert
Mr. Jim Bruner
Mr. Norman Miller
Mr. Karl Polen
Mr. Ray Rottas
Mr. N. Carl Tenney

Excused: Dr. Chuck Essigs

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the November 15, 2002 Regular Meeting and the December 5, 2002 Special Meeting of the ASRS Board

Motion: Ms. Bonnie Gonzalez moved to approve the minutes of the November 15, 2002, regular Board meeting and the December 5, 2002, special Board meeting.

Mr. Ray Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

3. Approval of the Consent Agenda

Motion: Ms. Bonnie Gonzalez moved to approve the consent agenda as written:

- A. Approval of Retirements, Refunds and Death Benefit
- B. Approval of System Transfers
- C. Application and Agreements with the Following Employers:
 - Rolling Hills Charter School
 - Tucson Preparatory School
 - Marana Domestic Water Improvement District

Mr. Ray Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding Contract Extensions for Mercer Investment Consulting, Inc., and Callan Associates, Inc.

Mr. Karl Polen, Chairman, Investment Review Committee, stated this is a routine contract extension for these two consultants. Mr. Norman Miller, Board Member, inquired as to the basis of the 3.6% fee increase. Mr. Paul Matson, Chief Investment Officer, responded that the original contract included an annual increase of 3% but stated he would check with Mr. Bob Wittsell, Procurement Manager. Mr. Maguire held this item for approval until Mr. Wittsell was consulted.

Mr. Wittsell informed the Board that the 3.6% increase was included in Mercer's original proposal.

Motion: Ms. Bonnie Gonzalez moved to approve the contract extension to January 20, 2004, for Mercer Investment Consulting, Inc. at a 3.6% fee increase and an extension to January 20, 2004, for Callan Associates, Inc. at a fee to be negotiated with each project for the final year of their five-year contracts.

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding the Large Cap Manager Search Award

The Large Cap manager search and analysis of the manager submissions was conducted by Mercer Investment Consulting and the ASRS staff. A discussion between staff and Mercer was held prior to determining the short list to be submitted to the evaluation committee. After a short list was agreed upon, Mercer prepared the background informational search books. Mercer and the ASRS staff then produced a one-page summary of each manager to provide to the evaluation committee. A meeting was held with the committee to determine which managers were to be interviewed. These managers were subsequently interviewed during the month of November

2002. The ASRS staff has negotiated Best and Final Offers (BFOs) with the investment managers that are being recommended to the Board.

Motion: Mr. Polen moved to authorize the award and termination of domestic equity large cap investment management mandates according to the following:

Core: Franklin Portfolio Associates
Barclays Global Advisors (On an unfunded basis)

Growth: Goldman Sachs Asset Management
Intech
Dresdner RCM (On an unfunded basis)

Value: LSV Asset Management
State Street Global Advisors
Aronson & Partners (On an unfunded basis and not to be contracted or funded before December 2003)

Terminate:
JP Morgan
Mellon Equity

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

6. Director's Report

Motion: Mr. Jim Bruner moved to accept the Director's Report as presented in the Board packet.

Ms. Bonnie Gonzalez seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

7. Presentation, Discussion and Appropriate Action Regarding the Executive Search Committee Status

Agenda item held and not addressed.

8. Presentation, Discussion and Possible Selection of the Arizona State Retirement System Director

Agenda item held and not addressed.

9. Presentation, Discussion and Appropriate Action Regarding the External Affairs Committee Meeting Status Update

Mr. Ray Rottas, Chairman, External Affairs Committee and Mr. Richard Stephenson, Deputy Director, External Affairs, gave a summary on the following:

Service Purchase; Clarification:

The ASRS receives an average of about 1,000 service purchase requests per month. About one out of every 200 service purchase requests are of the potentially abusive nature. We currently have about 60 service purchase requests of this potentially abusive nature. Although the number is small, the financial impact on the fund may be large. Some of these short the fund by more than \$250,000.

The following language should be added to the draft bill provided for you:

“The average compensation per full pay period times the number of pay periods per year, if the member has been employed by a participating employer for less than 12 months.”

Contributions Not withheld; Interest; Time Limits:

Retirement plan contributions are sometimes not made by the ASRS for employees who qualify for participation. Existing statutes (A.R.S. 38-738 B) provide an opportunity for employers to correct an error of not withholding or remitting contributions for an employee. To correct a failure to make the required contributions, both the employee and the employer are responsible to pay their portion of the contributions due. Additionally, A.R.S. 38-738 (B)(3) provides that the employer is responsible to pay the “...accumulated interest that would have accrued on the employer and the member contributions...” The employee and the employer both pay their due amounts directly to the ASRS.

The problem lies in that many employees do not take responsibility for ensuring their account information is correct until the time of retirement. This may result in an extensive period for which the employer is responsible for the accrued interest on both the employer’s and employee’s unpaid contributions. If the employer remits the total amount they owe, there is no incentive for the employee to remit their amount due in a timely manner. Existing statutes does not provide guidance as to whether the employer or employee has the responsibility to verify that the employee was eligible to participate.

If this bill were enacted, it would limit the liability of the employer to a maximum of 15 years. It would allow the employee to buy service credit prior to the 15 years pursuant to A.R.S. 38-743 or 38-745. It would encourage employees to pay in a timely manner by charging the employee interest on the amount they owe, beginning 90 days after notification that the employer has paid. The amendment would also specify that the employer is responsible for verifying eligibility.

Modified DROP; Conforming Changes

The Modified Deferred Retirement Option Program (DROP) will be available to employers and their employees as soon as the Supplement Retirement Savings Plan is approved and

implemented. The DROP program provides that the employer enter into an agreement with an employee who is eligible for retirement. This agreement specifies that the employee will work up to 36 months. At the end of this time period, the employee is eligible to purchase a similar amount of time and receive service credit.

Mr. Charles Whetstine, ASRS Legal Counsel, advised the ASRS that there are revisions needed in the existing statutes to comply with federal law. The bill revisions provide that an employee must have five years of credited service with the ASRS to be eligible to participate in the DROP. In addition, it specifies that DROP agreements are for a minimum of a six-month period. It specifies that the employer and the employees will continue to make long-term disability contributions. Additional revisions specify that if a member is unable to complete the DROP agreement due to death or disability, then the member or the member's beneficiary would be eligible to pay for the service part of the DROP agreement that was completed and have that credited to their retirement account. Additionally, the current annual compensation at the time of entering the DROP agreement will be used for calculating the cost of purchasing time. Lastly, a maximum aggregate of five years of "air time" may be purchased under any and all agreements under this section of law.

ASRS; Legal Counsel; Exemption

A.R.S. §41-492 provides that the Attorney General shall be the legal advisors for the departments of this state and legal services as the departments require. It further provides that no state agency other than the Attorney General shall employ legal counsel. However, within this same section of law it provides a list of nine exemptions. These exemptions do not include the ASRS. The revision to this bill would add the ASRS to the list of exemptions. This would enable the ASRS to secure their own legal counsel.

Technical Changes; Terminology

A.R.S. §38-718 (3) presently contains language pertaining to investment advisors holding the chartered financial analyst designation awarded by the Institute of Chartered Financial Analysts (ICFA). This organization has since changed to Association for Investment Management and Research (AIMR). The revision would reflect this change.

Health Insurance; Retiree Eligibility

This item will be held until a future Board meeting.

Motion: Mr. Rottas moved to direct the staff to seek suitable sponsors and favorable legislative dispositions for *Service Purchase; Clarification, Contributions Not Withheld; Interest; Time Limits, Modified DROP; Conforming and Other changes; ASRS Legal Counsel; Exemptions, and Technical Changes; Terminology.*

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

10. Presentation, Discussion and Appropriate Action Regarding the ASRS June 30, 2002 Financial Statement, the External Auditor's Review and Management Letter

Ms. Bonnie Gonzalez stated that the Budget and Audit Committee met on December 10, 2002, to review the Comprehensive Annual Financial Statement for the Fiscal Year 2002, the External Auditor's Review, and the Management Letter.

Motion: Ms. Bonnie Gonzalez moved that the Board accept the Comprehensive Annual Financial Statement for FY02, the External Auditor's Review, and the Management Letter.

Mr. Ray Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, presented an award received from the Government Finance Officer's Association. This award is the association's certificate of achievement in excellence in financial reporting. Mr. Guarino asked Ms. Jan Holt, ASRS Comptroller, to step forward to receive the award. The ASRS has received this award for 13 consecutive years.

11. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview on the period ending September 30, 2002

Mr. Terry Dennison, Principal, Mercer Investment Consulting, presented an economic and market review and reported on the Total Fund for the period ending September 30, 2002.

	<u>Quarter</u>	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>Inception</u>
Total Fund	-11.7	-10.2	-5.1	2.1	10.4
Benchmark*	-11.4	-11.1	-6.6	0.7	8.2
RM Public Funds Median	-9.6	-7.5	-2.6	2.2	-

*1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate,
1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE,
1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE,
7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE, and
1/1/00 to Present is 53% S&P 500/30% LB Aggregate/17% EAFE.

12. Presentation, Discussion and Appropriate Action Regarding the Performance of the MidCap Managers for the Period Ending September 30, 2002

Mr. Dennison reported on the performance of Franklin Portfolio Associates, Wellington Management Company, State Street Global Advisors, ASRS E4, Forstmann-Leff Associates, Frontier Capital Management, and ASRS E3 for the period ending September 30, 2002.

Mr. John Cone, President/Portfolio Manager, presented for Franklin Portfolio Associates.

	<u>Inception (7/1/02)</u>
ASRS	-15.14
S&P 400	-16.55
Value Added	1.41

Mr. Phillip Perelmuter, Portfolio Manager, and Ms. Elizabeth O'Hara, Relationship Manager presented for Wellington Management Company.

	<u>Inception (6/30/02)</u>
ASRS	-18.3
S&P 400	-16.6
Value Added	-1.7

Ms. Susan Bonfeld, Principal, Client Service, and Mr. Tom Rawlings, Principal, Portfolio Manager, presented for State Street Global Advisors.

	<u>3rd Quarter</u>	<u>1 Year</u>	<u>Inception (1/31/00)</u>
ASRS	-16.55	-4.67	-0.85
S&P 400	-16.55	-4.71	-1.11
Value Added	0.00	0.04	0.26

Mr. Michael Viteri, Portfolio Manager & Trader, Mr. Eric Rovelli, Portfolio Analyst, presented for the ASRS E4 portfolio.

	<u>Inception (6/30/02)</u>
ASRS E4	-18.44
S&P 400	-18.48
Value Added	0.03

Mr. Thomas Galvin, Sr. Portfolio Manager/Analyst, and Ms. Joelyn Flomenhaft, Director of Client Relations presented for Forstmann-Leff Associates.

	<u>Inception (7/01/02)</u>
ASRS	-21.21
S&P 400	-14.55
Value Added	-6.66

Mr. John G. Higgins, Sr. Vice President/Portfolio Manager, presented for Frontier Capital Management.

	<u>Inception (6/30/02)</u>
ASRS	-21.0
S&P 400	-14.6
Value Added	-6.4

Mr. Michael Viteri and Mr. Eric Rovelli presented on the ASRS E3 portfolio.

	<u>Quarter</u>	<u>YTD</u>	<u>1 Year</u>	<u>Inception (11/30/00)</u>
ASRS E3	-14.503	-22.313	-5.263	-14.072
S&P 400	-14.561	-23.108	-6.292	-14.923
Value Added	0.06	0.79	1.06	0.85

13. Board Requests for Agenda Items

Mr. Norman Miller requested an update on the request for proposal (RFP) for the corporate governance policy. Mr. Maguire stated that the RFP has been issued but is unsure of the deadline. He will check with Mr. Wittsell.

Mr. Karl Polen requested an update on the status of Columbia Asset Management with respect to the personnel changes that recently occurred. He also requested the status of the tactical asset allocation (TAA) RFP. Mr. Matson stated that the TAA short listing and interview process should begin at the end of January, 2003. Lastly, Mr. Polen requested review of the fourth quarter returns for both Forstmann-Leff and Frontier Capital Management as both of these managers have under-performed.

14. Call to the Public

Mr. Bill Peltier, Pima County Retired Teachers, requested to speak to the ASRS Board. He stated during November's Board meeting in Prescott, Arizona, the members in Tucson, who were teleconferenced into the meeting, were unable to hear the meeting. Mr. Peltier also inquired as to when the Board will be meeting in Tucson. Mr. Maguire stated that he will verify when the next meeting is scheduled in Tucson.

15. The next ASRS Board meeting is scheduled for Friday, January 17, 2003 at 8:30 a.m. in the 10th floor Board Room of the ASRS Phoenix Office, 3300 North Central Avenue, Phoenix, Arizona 85012

16. Adjournment of the ASRS Board.

Mr. Alan Maguire, Chairman, adjourned the December 20, 2002, meeting of the ASRS Board at 11:04 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Marina Chaves, Secretary

Date

Paul Matson, Director

Date